



## THE CITY OF SAN DIEGO

### OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Date Issued: May 23, 2008

IBA Report Number: 08-56

City Council Docket Date: May 27, 2008

Item Number: 331

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## Amendment to Agreement with the Outside Auditor

### OVERVIEW

On May 27, 2008, the City Council will be asked to approve an additional appropriation of \$1.38 million for the Agreement with Macias, Gini & O'Connell, LLP (Macias). Macias has served as the City's outside auditor for Fiscal Years 2004 through 2007. In that capacity, they have audited the annual financial statements for the City and its component units. To date, total funding of \$4.04 million has been authorized for audit work for all four fiscal years. Funding in the amount of \$979,800 is requested from the General Fund Appropriated Reserve, with the balance of \$400,200 contributed from other benefiting City funds. Upon approval of this action, total authorized funding for Macias will reach \$5.42 million.

On May 19, 2008, the City Council authorized the transfer of \$2.5 million from the Unallocated Reserve to replenish the Appropriated Reserve, in part, to provide funds for this anticipated action. If this action is approved, the balance of the Appropriated Reserve will be \$1.59 million.

### FISCAL/POLICY DISCUSSION

On April 22, 2008, the City Council discussed and received the Comprehensive Annual Financial Report (CAFR) for Fiscal Year 2006 and the related Single Audit and Yellow Book Reports. The Comptroller anticipates completing the CAFR for Fiscal Year 2007 in June 2008. If so, Macias will likely complete their audit work in July 2008. The Comptroller's Office has informed the IBA that Macias invoices for audit work performed for Fiscal Years 2004 through 2006, including cost overruns, have been paid in full.

Office of Independent Budget Analyst

202 C Street, MS 3A • San Diego, CA 92101

Tel (619) 236-6555 Fax (619) 236-6556



DIVERSITY  
IT TAKES US ALL TOGETHER

As noted in the Comptroller's memorandum dated April 11, 2008, an additional appropriation of \$1.38 million is requested for the Macias Agreement to cover cost overruns associated with unanticipated work for Macias. In their letter dated March 10, 2008, Macias explains their reasons for incurring cost overruns, which include the re-opening of the Fiscal Year 2005 audit. The Comptroller's Office has informed the IBA it became apparent in September 2007 that the appropriation to complete the audit work for Fiscal Year 2007 would be insufficient. Lacking better detail on the total expected additional audit costs, a decision was made to wait until these costs could be better ascertained before seeking additional authorization from the City Council. It was hoped this would eliminate the need to seek further authorizations at a later date.

The IBA understands the circumstances that led to the Macias cost overruns over original estimates; however, we believe that this information should have been shared with the City Council sooner. This request was intended to be scheduled for discussion at the Audit Committee meeting of May 12, 2008, however that meeting was subsequently canceled. As the next Audit Committee meeting is scheduled for June 9, 2008, it was not feasible to first discuss this action with the Audit Committee and then docket for City Council approval prior the end of the current fiscal year (June 30, 2008). However, the status of the annual audits is a standing item on the agenda for each Audit Committee meeting. Updates regarding potential cost overruns related to the agreement with the outside auditor should be discussed as part of these status reports.

The IBA recommends that, in the future, information concerning potential audit cost overruns be shared with the Audit Committee and the City Council as soon as possible. In addition to allowing for better resource planning, ongoing communication would avoid the perception that work may have been permitted, without proper authorization or the identification of sufficient funding.

## CONCLUSION

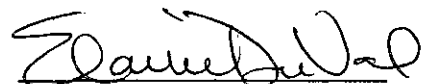
The IBA recommends approval of the action to authorize funds in the amount of \$1.38 million for the Macias Agreement, with \$979,800 to be funded from the Appropriated Reserve. In addition, the IBA recommends that, in the future, information concerning potential audit cost overruns be shared with the Audit Committee and the City Council as soon as possible.



Jeff Kavar  
Fiscal & Policy Analyst



APPROVED: Andrea Tevlin  
Independent Budget Analyst



Elaine DuVal  
Fiscal & Policy Analyst

001039

City of San Diego  
Office of the Comptroller  
Memorandum

331  
05/27

Date: April 11, 2008

To: Honorable City Councilmember's

From: Greg Levin, CPA City Comptroller

Subject: Macias Gini O'Connell contract amendments for audit services related to the 2004, 2005, 2006 and 2007 CAFRs

Attached is a Council Action to request a contract amendment for the audit of financial statements for fiscal years 2004, 2005, 2006 and 2007 CAFRs by Macias Gini & O'Connell. Costs incurred for FY 2004-2006 have exceeded expectations by approximately \$1,000,000 which also impacts the amount remaining for completion of the FY 2007 CAFR. These overruns were primarily due to weaknesses in internal controls over financial reporting as well as additional procedures needed to address items/events that were raised by the City Attorney, including but not limited to the allegations on the illegality of the Preservation of Benefits plan and the completeness of related footnote disclosures. A breakdown of the additional costs incurred by Macias, as a result of all extra procedures deemed necessary, is attached to this memo (Attachment B).

The requested approval of the amendments discussed above will result in the use of approximately of \$1,000,000 from the general fund appropriated reserve. A breakdown of all contracts and amendments is identified below.

	11/29/2004 R-299905	8/8/2005 R-300771	12/4/2006 R-302153	7/24/2007 R-302879	4/11/2008 Request	FINAL CONTRACT
FY 04 Audit	715,479		135,000			\$ 850,479
FY 05 Audit		844,977	70,000		1,009,940	\$ 1,924,917
FY 06 Audit			888,634	226,196	185,000	\$ 1,299,830
FY 07 Audit				1,159,710	185,000	\$ 1,344,710
Total Award .....						<u>\$ 5,419,936</u>

CC: Jay Goldstone, COO  
Mary Lewis, CFO  
Andrea Tevlin, IBA  
Mark Blake, Deputy City Attorney-Finance and Disclosure

Attachment:  
Memo from Macias Gini O'Connell explaining overruns



MACIAS GINI & O'CONNELL LLP  
CERTIFIED PUBLIC ACCOUNTANTS & MANAGEMENT CONSULTANTS

001041

3000 S Street, Suite 300  
Sacramento, CA 95816  
916.441.1100

2175 N. California Boulevard, Suite 645  
Walnut Creek, CA 94596  
925.938.1100

505 14th Street, 5th Floor  
Oakland, CA 94612  
510.270.8974

515 S. Figueroa Street, Suite 325  
Los Angeles, CA 90071  
213.236.6400

402 West Broadway, Suite 400  
San Diego, CA 92101  
619.592.1100

March 10, 2008

Kevin Faulconer  
Councilmember, Second District  
Chairperson, Audit Committee  
City of San Diego  
202 C Street  
San Diego, CA 92101

Dear Councilmember Faulconer:

We would like to briefly explain to you the reason for our significant budget overruns related to the City's 2005 CAFR audit.

As we have periodically reported to the Committee on the status of our engagement and the level of effort necessary to properly complete the engagement, we are providing the following summary, which includes all of the previously discussed items amounting to approximately \$455,000. Cumulative budget overruns related to the performance of the 2004 and 2005 audits approximates \$1 million. Our procedures went beyond our estimates in part due to weaknesses in internal controls over financial reporting (which we and our predecessor auditor identified in previous reports to the Committee<sup>1</sup>) that required us to perform additional extensive procedures and the performance of our procedures related to the City's 2005 CAFR audit due to items/events that were raised by the Office of City Attorney. These included additional items in the City attorney's Statement of Financial Accounting Standards (SFAS) No. 5 "Accounting for Contingencies", letter as well as additional procedures that we performed with respect to allegations on the illegality of the Preservation of Benefits plan and the completeness of related footnote disclosures. While our initial and final conclusion was that the impact of these additional issues did not require us to recall or modify our opinion of the City's fiscal year 2006 CAFR, ultimately the decision was made to revise disclosures in Notes 13 and 18 and to the Letter of Transmittal. Our review of the items/events raised by City Attorney and the surrounding discussion thereof resulted in additional procedures and time incurred amounting to approximately \$350,000 of audit fees to the City's for the 2005 CAFR.

<sup>1</sup> FY 2003, 2004 & 2005 Yellow Book Reports.

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The remaining \$650,000 is broken down as follows (Note, this relates to both 2004 and 2005 audits);

Audit Area	Reason		Cost Overrun
Cash	Extensive review of several versions of the bank reconciliation (numerous reconciling items that were older than a few years), and other audit procedures (escrow cash held for developers, etc).	\$	80,000
Accounts receivable	Additional testwork performed in this area due to invoices that were considerably older than anticipated.		50,000
Land held for resale	Additional documentation and testing related to Land-held-for resale (Reconciling City G/L to component unit (CCDC, SEDC) custodial records, Land acquisition credits procedures.		50,000
Capital assets	Additional testing related to reconciling City G/L to Water/Sewer departments systems (GIS). Also procedures related to documentation/testing of C.I.P., interest capitalization that had not been performed before.		100,000
Claims liability	Additional procedures related to testing of data provided to the actuary. Material weaknesses related to the City updating case reserves (public liability – City Attorney’s office vs Risk management) required additional procedures applied to data transferred to the actuary.		50,000
Net Pension Obligation	This highly controversial and complex area required a historical review of supporting documentation for prior contributions/expenses (going back at least 12 years), a review/testing of City’s procedures for accurately capturing payroll information, extensive review of City’s current complex methodology of calculating its contributions (MP-1/MP-2), analysis of the City’s NPO schedule by our consulting actuary,		200,000
Component units	Our other audit teams performed procedures on the 2004 balances of the CCDC, SEDC, SDDPC that had been previously audited by C&L.		70,000
Financial statement preparation	Professional standards review of several iterations of the City’s CAFR to ensure that a minimum level of disclosure was maintained for 2004 and 2005.		50,000
	Total	\$	650,000

A number of the reasons for the budget overruns listed above have been resolved and therefore we do not expect overruns in the magnitude as described above for either the 2006 or 2007

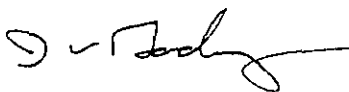
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audits. However, we do anticipate continued expanded procedures and the related budget overages<sup>2</sup> for each of these yearly audits as follows;

Audit Area	Reason		Cost Overrun
Cash	(Review escrow cash bank statements - cash held for developers, etc).	\$	30,000
Accounts receivable	Additional testwork performed in this area due to a significant number of invoices that were considerably older than anticipated.		20,000
Capital assets	Additional testing related to reconciling City G/L to Water/Sewer departments systems (GIS). Also procedures related to documentation/testing of C.I.P., interest capitalization that had not been performed before.		60,000
Claims liability	Additional procedures related to testing of data provided to the actuary. Material weaknesses related to the City updating case reserves (public liability - City Attorney's office vs Risk management) required additional procedures applied to data transferred to the actuary.		40,000
Net Pension Obligation	Updating of ongoing litigation and extended procedures of consulting actuary.		55,000
Financial statement preparation	Professional standards review of multiple iterations of the City's CAFR.		15,000
Single audit	Additional programs audited and less reliance on internal controls at the department level.		100,000
Exhibit E (Sewer department compliance)	Expanded scope of procedures performed.		50,000
	Total	\$	370,000

As a reminder, we need to complete those procedures we deem necessary to comply with auditing standards generally accepted in United States of America and the standards for financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. As we complete our procedures, it can be expected that additional questions may arise. We will, as we have throughout the audit, work diligently to address any such questions with the City's staff.

Very truly yours,



Jim Godsey, Partner

<sup>2</sup> Projected budget overages are deemed to be sufficient, but the total estimated overages are dependent on a reasonable FASB 5 process.

Macias Gini & O'Connell LLP

Cc: Mr. Jay Goldstone, Chief Operating Officer  
Ms. Mary Lewis, Chief Financial Officer  
Mr. Greg Levin, Comptroller

**001044**

# REQUEST FOR COUNCIL ACTION

CITY OF SAN DIEGO

001045

1. CERTIFICATE NUMBER  
(FOR AUDITOR'S USE ONLY)

AC 2800679

TO:  
CITY ATTORNEY2. FROM (ORIGINATING DEPARTMENT):  
Auditor & Comptroller3. DATE:  
07/16/2007

4. SUBJECT:  
Amendment to the consultant Agreements with Macias Gini & O'Connell, LLP (Macias) to Audit the City's Fiscal Year 2004, 2005, 2006 and 2007 Comprehensive Annual Financial Reports (CAFRs).

5. PRIMARY CONTACT (NAME, PHONE &amp; MAIL STA.)

Greg Levin, 236-6162 MS6A

6. SECONDARY CONTACT (NAME, PHONE &amp; MAIL STA.)

Tracy McCraner 235-5821 MS6A

7. CHECK BOX IF REPORT TO  
COUNCIL IS ATTACHED ☐

## 8. COMPLETE FOR ACCOUNTING PURPOSES

Box 8 attached accounting line distribution

	FUND	DEPT	ORG	ACCT	JOB ORDER	AMOUNT
1		602		48818	000602	\$ 979,800
2	41500	760	163	4151	002093	\$ 124,200
3	41506	776	455	4151	776260	\$ 96,600
4	105051	9321	2004	4151	002004	\$ 8,280
5	10226	918		4151	091811	\$ 9,660
6	102211	102211	300	4151	000300	\$ 9,660
7	98805	97481	1002	4151	001002	\$ 151,800
TOTAL AC						\$ 1,380,000

9. ADDITIONAL INFORMATION / ESTIMATED COST:

See attachment A

## 10. ROUTING AND APPROVALS

ROUTE (#)	APPROVING AUTHORITY	APPROVAL SIGNATURE	DATE SIGNED	ROUTE (#)	APPROVING AUTHORITY	APPROVAL SIGNATURE	DATE SIGNED
1	ORIGINATING DEPARTMENT	<i>Greg Levin</i>	4/11/08	8	CFO	<i>W. H. H. H.</i>	4/15/08
2				9	COO	<i>W. H. H. H.</i>	4/15/08
3				10	CITY ATTORNEY	<i>W. H. H. H.</i>	5/8/08
4	LIAISON OFFICE	<i>SC</i>	5/9/08	11	ORIGINATING DEPARTMENT	<i>W. H. H. H.</i>	
5				DOCKET COORD: <i>SC</i> COUNCIL LIAISON: <i>SC</i>			
6				<input checked="" type="checkbox"/> COUNCIL PRESIDENT <input type="checkbox"/> SPOB <input type="checkbox"/> CONSENT <input checked="" type="checkbox"/> ADOPTION <input type="checkbox"/> REFER TO: <i>SC</i> COUNCIL DATE: 5/27/08			
7							

11. PREPARATION OF:

☒ RESOLUTION(S)☐ ORDINANCE(S)☐ AGREEMENT(S)☐ DEED(S)

- Amend the audit contract with Macias Gini & O'Connell for fiscal years 2004 – 2007 audits of the City's Comprehensive Annual Financial reports by increasing a total amount not to exceed \$1,380,000.
- Authorizing the Comptroller's Office to transfer an amount up to \$979,800 from the appropriated reserve department 602 to the General Fund Citywide department 601 org 2450 for audit services for the expenditure of the General Fund portion of these audit expenditures.

11A. STAFF RECOMMENDATIONS:

Adopt the resolution



001047

**EXECUTIVE SUMMARY SHEET**  
CITY OF SAN DIEGO

DATE ISSUED: REPORT NO:  
ATTENTION: Council President and City Council  
ORIGINATING DEPARTMENT: City Comptroller  
SUBJECT: Amendment to the contracts with the City's Independent  
External Auditor (Macias Gini & O'Connell LLP.) for fiscal  
years 2004 - 2007 Audit Services  
COUNCIL DISTRICT(S): n/a  
CONTACT/PHONE NUMBER: Greg Levin 236-6162 / Tracy McCraner 235-5821

REQUESTED ACTION: Approve the cumulative increase in fiscal years 2004 through 2007  
audit contracts of an amount not to exceed \$1,380,000.

STAFF RECOMMENDATION: Approve requested action.

EXECUTIVE SUMMARY: On January 27, 2004, the City filed a voluntary financial disclosure concerning, in part, certain errors and correctible statements in the City's fiscal year 2002 Comprehensive Annual Financial Report ("CAFR"). As a result, the fiscal year 2003, fiscal year 2004, fiscal year 2005 and 2006 were significantly delayed.

The City retained Macias, Gini & O'Connell, LLP (Macias) to perform the audits of the City's CAFRs for fiscal years ending June 30, 2004 through 2007, as well as the Single Audits and related entities audits for same fiscal years, including the City's Redevelopment Agency. The City has incurred greater than expected costs for the audits of CAFR's for FY 2004 - 2007, the additional procedures identified by Macias as needed due to weaknesses in internal controls over financial reporting, and items/events raised by the City Attorney which included allegations on the illegality of the Preservation of Benefits plan. The Mayor is requesting that we amend the total award for fiscal years 2004 through 2007 as outlined in Attachments A and B.

FISCAL CONSIDERATIONS: The total cost of this action will be \$1,380,000. All audit costs will be charged directly to the benefited funds under audit pursuant to the attached schedule.

PREVIOUS COUNCIL and/or COMMITTEE ACTION:

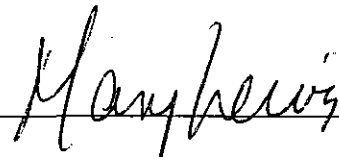
Resolution 299905 dated 11/29/2004  
Resolution 300771 dated 08/08/2005  
Resolution 302153 dated 12/04/2006  
Resolution 302879 dated 07/24/2007

COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS: n/a

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KEY STAKEHOLDERS AND PROJECTED IMPACTS: To return to the public finance market the City must issue its basic financial statements. In addition, to continue to be eligible for federal grants in excess of a total of \$500,000 the City must complete its federal single audits.

  
\_\_\_\_\_  
City Comptroller

  
\_\_\_\_\_  
Chief Financial Officer

The City of San Diego  
CERTIFICATE OF CITY AUDITOR AND COMPTROLLER

001049

CERTIFICATE OF UNALLOTTED BALANCE

ORIGINATING

AC 2800679

DEPT.  
NO.:

I HEREBY CERTIFY that the money required for the allotment of funds for the purpose set forth in the foregoing resolution is available in the Treasury, or is anticipated to come into the Treasury, and is otherwise unallotted.

Amount: \_\_\_\_\_ Fund: \_\_\_\_\_

Purpose: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Date: \_\_\_\_\_ By: \_\_\_\_\_

ACCOUNTING DATA										
ACCTG. LINE	CY PY	FUND	DEPT	ORG.	ACCOUNT	JOB ORDER	OPERATION ACCOUNT	BENF/ EQUIP	FACILITY	AMOUNT
TOTAL AMOUNT										

FUND OVERRIDE ☐

CERTIFICATION OF UNENCUMBERED BALANCE

I HEREBY CERTIFY that the indebtedness and obligation to be incurred by the contract or agreement authorized by the hereto attached resolution, can be incurred without the violation of any of the provisions of the Charter of the City of San Diego; and I do hereby further certify, in conformity with the requirements of the Charter of the City of San Diego, that sufficient moneys have been appropriated for the purpose of said contract, that sufficient moneys to meet the obligations of said contract are actually in the Treasury, or are anticipated to come into the Treasury, to the credit of the appropriation from which the same are to be drawn, and that the said money now actually in the Treasury, together with the moneys anticipated to come into the Treasury, to the credit of said appropriation, are otherwise unencumbered.

Not to Exceed: \$ 1,380,000

Vendor: Macias Gini O'Connell LLP

Purpose: Authorizing contracts amendments for fiscal years ending June 30, 2004, 2005 2006 and 2007 for audit services related to the City's Comprehensive Annual Financial reports, Single Audits and the Component unit audits for the City of San Diego.

Date: March 27, 2008

By: Tracy McCraher

ACCOUNTING DATA										
ACCTG. LINE	CY PY	FUND	DEPT	ORG.	ACCOUNT	JOB ORDER	OPERATION ACCOUNT	BENF/ EQUIP	FACILITY	AMOUNT
1	0	100	602		48818	000602				979,800.00
2		41500	760	163	4151	002093				124,200.00
3		41506	776	455	4151	776260				96,600.00
4		105051	9321	2004	4151	002004				8,280.00
5		10226	918		4151	091811				9,660.00
6		102211	102211	300	4151	000300				9,660.00
7		98805	97481	1002	4151	001002				151,800.00
TOTAL										\$1,380,000.00

RESOLUTION NUMBER R-\_\_\_\_\_

DATE OF FINAL PASSAGE \_\_\_\_\_

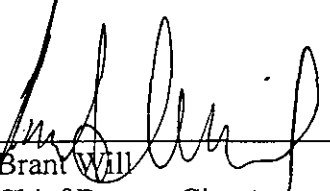
A RESOLUTION OF THE COUNCIL OF THE CITY OF SAN DIEGO AUTHORIZING THE MAYOR TO AMEND THE AGREEMENT WITH MACIAS GINI & O'CONNELL LLP FOR AUDIT SERVICES FOR THE CITY OF SAN DIEGO FISCAL YEAR 2006 AND 2007 FINANCIAL STATEMENTS BY INCREASING THE TOTAL AMOUNT OF THE AGREEMENT NOT TO EXCEED \$1,380,000 AND TRANSFERRING AN AMOUNT UP TO \$979,800 FROM THE APPROPRIATED RESERVE TO PAY FOR THE EXPENDITURES.

BE IT RESOLVED, by the Council of the City of San Diego that the Mayor is hereby authorized and empowered to amend the agreement with Macias Gini & O'Connell LLP [Agreement], for audit services for the City of San Diego fiscal year 2006 and 2007 financial statements to allow for additional expenditures under the Agreement in an amount not to exceed \$1,380,000; and

BE IT FURTHER RESOLVED, that the Auditor and Comptroller is authorized to transfer up to \$979,800 from the Appropriated Reserve, Dept. 601, to the General Fund Citywide Department, Dept. 602, org. 2450, to pay the General Fund portion of the audit expenditures.

APPROVED: MICHAEL J. AGUIRRE, City Attorney

By

  
\_\_\_\_\_  
Brant Will  
Chief Deputy City Attorney

BCW:jdf  
05/08/08  
Or.Dept:Finance  
R-2008-1045

001052

I hereby certify that the foregoing Resolution was passed by the Council of the City of San Diego, at this meeting of \_\_\_\_\_.

ELIZABETH S. MALAND  
City Clerk

By \_\_\_\_\_  
Deputy City Clerk

Approved: \_\_\_\_\_  
(date)

\_\_\_\_\_  
JERRY SANDERS, Mayor

Vetoed: \_\_\_\_\_  
(date)

\_\_\_\_\_  
JERRY SANDERS, Mayor